Local Government Services, Inc. (LGS) – Background on Loans with IASB

Summary

If LGS did not exist as an entity, all of the same programs, and the revenues and expenditures associated with them, would flow through the Association's finances rather than some through the Association and some through LGS. The programs and services of both entities both work for the same mission, are just to separate the core non-profit mission work from the non-core mission work to ensure proper separation for tax purposes.

Financial reporting for all Association controlled entities including LGS are presented in consolidated financial statements. All transactions between controlled entities are completely eliminated when presenting the consolidated Association financial statements including the loans between the entities. The two separate entities are merely an accounting issue, but should be viewed as two halves of whole.

Below you will find a detailed outline of how IASB came to create LGS. It includes the need for IASB to invest about $5 million, which went into the purchase of the 6000 Grand office building, furnishings, and related expenses.

Background

Local Government Services (LGS) is a for-profit, wholly-owned subsidiary of the Iowa Association of School Boards (Association). LGS operates in a support capacity for the Association, which includes technology, infrastructure, and office operations. LGS also seeks to create aggregation opportunities for members of the Association and other educational and government institutions in Iowa and other states, and operates the Association's sponsored programs. LGS is run for the benefit of the members of the Association, and all net revenue returned to the Association is invested into member services such as training for school boards. By creating new business services and making existing business services more efficient, LGS preserves resources for the Association's members for student achievement and allows administrators to focus on the core mission of public education. Business services include marketing and administrative support for both nonprofits and intergovernmental organizations, PaySchools, and other Association sponsored programs.

LGS is governed by a Board of Directors. All LGS board members also serve as board members of the Association to ensure LGS is ultimately operating for the benefit of the Association and its members. The Association's Executive Director is the Chairman of the LGS Board of Directors. Prior to April 2009, the President of LGS was also the CFO of the Association. Subsequent to April 2009, it appears the position of LGS President was vacant As of June 30, 2009, LGS employed approximately 20 staff members including IT, Accounting, Print/Production, and Business Services.

History of LGS and Loans

In February 2003, the Association engaged a CPA firm to review and evaluate their finances with respect to unrelated business income on the various business programs and advice on any risks to their non-profit status. The CPA firm reported that once an exempt organization has income representing 30 percent or more of their revenues, their exempt status can be called into question. This report was presented to the Association's Board of Directors by Larry Sigel in March 2003. The Association did not take action at that time, but began keeping a close watch on their income from business programs.

During the 2004-05 fiscal year, the sponsorship and administration of the various business service programs reached around the 30 percent level. In May 2005, Ron Rice reported to the Association's board of directors that the Association had begun discussions of involving other state school board associations in the sponsorship of the PaySchools program. During that meeting, Ron Rice told the board that management may be bringing the board a request for approval of a for-profit subsidiary organization.

During September 2005, Ron Rice shared that a new entity, Local Government Services, was being established to spin-off some of the business services into a for-profit subsidiary. Larry Sigel noted that establishing the for-profit subsidiary to receive business services income could help the Association maintain its tax-exempt status. Nolden Gentry, who was legal counsel at the time, then reviewed with the board the Articles of Incorporation and Bylaws, and noted the Association's board would control and designate the LGS board members. The Association's board approved the Articles and Bylaws of LGS at this board meeting.

At the November 2005 Association board of directors meeting, the board voted to purchase 1000 shares of LGS stock for $10,000. It was noted that the Association owned and will own 100 percent of LGS stock. In effect, IASB made an investment

At the January 2006 meeting of the Association's board of directors, the board received a report on facility needs and various purchasing scenarios for new office building space. The board authorized Ron Rice to make an offer on the 6000 Grand building.

At the March 2006 Association board of directors meeting, the board approved the purchase of the building at 6000 Grand and discussed various financing scenarios and whether it was most appropriate to purchase the building through the Association or LGS. The board authorized the Executive Director to determine the most advantageous structure and if necessary, assign the building purchase agreement to LGS. These decisions were finalized by the Association's board of directors at their meeting on April 12, 2006.

The Executive Director and management in conjunction with the external auditors determined the building was best owned and financed by LGS rather than the Association. This was primarily due to the fact that the building at 6000 Grand would have outside tenants renting space from the Association and therefore the Association would have unrelated business income from the rental space. The Association provided a loan to LGS for purchase of the 6000 Grand building.

In September 2006, the Association's board approved a services agreement, various sponsorship agreements, and a lease agreement between the Association and LGS. The Association also made a capital contribution to LGS for all furniture, fixtures, equipment, hardware and software. In return, the Association received 27,100.56 additional shares of LGS stock at $10/share. The Association also authorized a loan payment to LGS for purchasing the PaySchools software from the technology vendor in the amount of $300,000.

In November 2006, LGS and the Association entered into an ongoing cash flow agreement. The agreement allowed the Association to loan funds to LGS for cash flow purposes. An interest rate equal to the Association's earned daily rate plus .5 percent was established for any amounts loaned from the Association to LGS.

The purchase of the building and expenses associated with the build out of the office space, amounted to approximately $3.5 million. LGS also purchased furniture, equipment, and hardware & software after the move to 6000 Grand. These purchases required cash flow advances from the Association and were added to the loan balance.

Between 2006 and 2009, the Association and LGS continued to review the allocation of revenues and expenses between entities in an attempt to ensure all active business service revenues were reported through LGS, and only passive sponsorships were reported through the Association. The Association's and LGS' boards of directors took multiple actions during that time to revise agreements, pricing, and transition participation agreements between entities in an attempt to ensure revenues and expenses were properly recorded.

The total loan balance including the purchase of the 6000 Grand building, build out expenditures, the PaySchools software acquisition, the transition and purchase of hardware, software, furniture, fixture and equipment, and additional cash flow advances amounted to approximately $5 million as of June 30, 2009. Management had discussed with the external auditors on multiple occasions during late 2008 and 2009 regarding their intention to recapitalize and have LGS issue additional shares of stock to the Association to essentially clear off this loan balance and prevent the loan amount from growing larger in the future. The action is still under consideration and has been discussed with the board of directors. The loan remains on the books as a payable to the Association and a receivable from LGS.